

the cost of such treatment is deductible under section 213 by the person treated. An organization, all the accommodations of which qualify as being part of a "skilled nursing facility" within the meaning of 42 U.S.C. 1395x(j), may qualify as a "hospital" within the meaning of subdivision (i) of this subparagraph if its principal purpose or function is the providing of hospital or medical care. For taxable years ending after June 28, 1968, the term "hospital" also includes cooperative hospital service organizations which meet the requirements of section 501(e) and § 1.501(e)-1. The term "hospital" does not, however, include convalescent homes or homes for children or the aged, nor does the term include institutions whose principal purpose or function is to train handicapped individuals to pursue some vocation. An organization whose principal purpose or function is the providing of medical education or medical research will not be considered a "hospital" within the meaning of subdivision (i) of this subparagraph, unless it is also actively engaged in providing medical or hospital care to patients on its premises or in its facilities, on an inpatient or outpatient basis, as an integral part of its medical education or medical research functions. See, however, subparagraph (2) of this paragraph with respect to certain medical research organizations.

(2) *Certain medical research organizations—(i) Introduction.* A medical research organization is described in section 170(b)(1)(A)(iii) if the principal purpose or functions of such organization are medical research and if it is directly engaged in the continuous active conduct of medical research in conjunction with a hospital. In addition, for purposes of the 50 percent limitation of section 170(b)(1)(A) with respect to a contribution, during the calendar year in which the contribution is made such organization must be committed to spend such contribution for such research before January 1 of the fifth calendar year which begins after the date such contribution is made. An organization need not receive contributions deductible under section 170 to qualify as a medical research organization and such organization need not be committed to spend amounts to which

the limitation of section 170(b)(1)(A) does not apply within the 5-year period referred to in this subdivision. However, the requirement of continuous active conduct of medical research indicates that the type of organization contemplated in this subparagraph is one which is primarily engaged directly in the continuous active conduct of medical research, as compared to an inactive medical research organization or an organization primarily engaged in funding the programs of other medical research organizations. As in the case of a hospital, since an organization is ordinarily not described in section 170(b)(1)(A)(iii) as a hospital unless it functions primarily as a hospital, similarly a medical research organization is not so described unless it is primarily engaged directly in the continuous active conduct of medical research in conjunction with a hospital. Accordingly, the rules of this subparagraph shall only apply with respect to such medical research organizations.

(ii) *General rule.* An organization (other than a hospital described in subparagraph (1) of this paragraph) is described in section 170(b)(1)(A)(iii) only if within the meaning of this subparagraph:

(a) The principal purpose or functions of such organization are to engage primarily in the conduct of medical research, and

(b) It is primarily engaged directly in the continuous active conduct of medical research in conjunction with a hospital which is (1) described in section 501(c)(3), (2) a federal hospital, or (3) an instrumentality of a governmental unit referred to in section 170(c)(1).

However, in order for a contribution to such organization to qualify for purposes of the 50 percent limitation of section 170(b)(1)(A), during the calendar year in which such contribution is made or treated as made, such organization must be committed (within the meaning of subdivision (viii) of this subparagraph) to spend such contribution for such active conduct of medical research before January 1 of the fifth calendar year beginning after the date such contribution is made. For the meaning of the term "medical research" see subdivision (iii) of this subparagraph. For the meaning of the

term “principal purpose or functions” see subdivision (iv) of this subparagraph. For the meaning of the term “primarily engaged directly in the continuous active conduct of medical research” see subdivision (v) of this subparagraph. For the meaning of the term “medical research in conjunction with a hospital” see subdivision (vii) of this subparagraph.

(iii) *Definition of medical research.* Medical research means the conduct of investigations, experiments, and studies to discover, develop, or verify knowledge relating to the causes, diagnosis, treatment, prevention, or control of physical or mental diseases and impairments of man. To qualify as a medical research organization, the organization must have or must have continuously available for its regular use the appropriate equipment and professional personnel necessary to carry out its principal function. Medical research encompasses the associated disciplines spanning the biological, social and behavioral sciences. Such disciplines include chemistry, (biochemistry, physical chemistry, bioorganic chemistry, etc.), behavioral sciences (psychiatry, physiological psychology, neurophysiology, neurology, neurobiology, and social psychology, etc.), biomedical engineering (applied biophysics, medical physics, and medical electronics, e.g., developing pacemakers and other medically related electrical equipment), virology, immunology, biophysics, cell biology, molecular biology, pharmacology, toxicology, genetics, pathology, physiology, microbiology, parasitology, endocrinology, bacteriology, and epidemiology.

(iv) *Principal purpose or functions.* An organization must be organized for the principal purpose of engaging primarily in the conduct of medical research in order to be an organization meeting the requirements of this subparagraph. An organization will normally be considered to be so organized if it is expressly organized for the purpose of conducting medical research and is actually engaged primarily in the conduct of medical research. Other facts and circumstances, however, may indicate that an organization does not meet the principal purpose require-

ment of this subdivision even where its governing instrument so expressly provides. An organization that otherwise meets all of the requirements of this subparagraph (including this subdivision) to qualify as a medical research organization will not fail to so qualify solely because its governing instrument does not specifically state that its principal purpose is to conduct medical research.

(v) *Primarily engaged directly in the continuous active conduct of medical research.* (a) In order for an organization to be primarily engaged directly in the continuous active conduct of medical research, the organization must either devote a substantial part of its assets to, or expend a significant percentage of its endowment for, such purposes, or both. Whether an organization devotes a substantial part of its assets to, or makes significant expenditures for, such continuous active conduct depends upon the facts and circumstances existing in each specific case. An organization will be treated as devoting a substantial part of its assets to, or expending a significant percentage of its endowment for, such purposes if it meets the appropriate test contained in paragraph (c)(2)(v)(b) of this section. If an organization fails to satisfy both of such tests, in evaluating the facts and circumstances, the factor given most weight is the margin by which the organization failed to meet such tests. Some of the other facts and circumstances to be considered in making such a determination are:

(1) If the organization fails to satisfy the tests because it failed to properly value its assets or endowment, then upon determination of the improper valuation it devotes additional assets to, or makes additional expenditures for, such purposes, so that it satisfies such tests on an aggregate basis for the prior year in addition to such tests for the current year.

(2) The organization acquires new assets or has a significant increase in the value of its securities after it had developed a budget in a prior year based on the assets then owned and the then current values.

(3) The organization fails to make expenditures in any given year because of the interrelated aspects of its budget

and long-term planning requirements, for example, where an organization prematurely terminates an unsuccessful program and because of long-term planning requirements it will not be able to establish a fully operational replacement program immediately.

(4) The organization has as its objective to spend less than a significant percentage in a particular year but make up the difference in the subsequent few years, or to budget a greater percentage earlier year and a lower percentage in a later year.

(b) For purposes of this section, an organization which devotes more than one half of its assets to the continuous active conduct of medical research will be considered to be devoting a substantial part of its assets to such conduct within the meaning of paragraph (c)(2)(v)(a) of this section. An organization which expends funds equaling 3.5 percent or more of the fair market value of its endowment for the continuous active conduct of medical research will be considered to have expended a significant percentage of its endowment for such purposes within the meaning of paragraph (c)(2)(v)(a) of this section.

(c) Engaging directly in the continuous active conduct of medical research does not include the disbursing of funds to other organizations for the conduct of research by them or the extending of grants or scholarships to others. Therefore, if an organization's primary purpose is to disburse funds to other organizations for the conduct of research by them or to extend grants or scholarships to others, it is not primarily engaged directly in the continuous active conduct of medical research.

(vi) *Special rules.* The following rules shall apply in determining whether a substantial part of an organization's assets are devoted to, or its endowment is expended for, the continuous active conduct of medical research activities:

(a) An organization may satisfy the tests of paragraph (c)(2)(v)(b) of this section by meeting such tests either for a computation period consisting of the immediately preceding taxable year, or for the computation period consisting of the immediately preceding four taxable years. In addition, for taxable years beginning in 1970, 1971,

1972, 1973, and 1974, if an organization meets such tests for the computation period consisting of the first four taxable years beginning after December 31, 1969, an organization will be treated as meeting such tests, not only for the taxable year beginning in 1974, but also for the preceding four taxable years. Thus, for example, if a calendar year organization failed to satisfy such tests for a computation period consisting of 1969, 1970, 1971, or 1972, but on the basis of a computation period consisting of the years 1970 through 1973, it expended funds equaling 3.5 percent or more of the fair market value of its endowment for the continuous active conduct of medical research, such organization will be considered to have expended a significant percentage of its endowment for such purposes for the taxable years 1970 through 1974. In applying such tests for a four-year computation period, although the organization's expenditures for the entire four-year period shall be aggregated, the fair market value of its endowment for each year shall be summed, even though, in the case of an asset held throughout the four-year period, the fair market value of such an asset will be counted four times. Similarly, the fair market value of an organization's assets for each year of a four-year computation period shall be summed.

(b) Any property substantially all the use of which is "substantially related" (within the meaning of section 514(b)(1)(A)) to the exercise or performance of the organization's medical research activities will not be treated as part of its endowment.

(c) The valuation of assets must be made with commonly accepted methods of valuation. A method of valuation made in accordance with the principles stated in the regulations under section 2031 constitutes an acceptable method of valuation. Assets may be valued as of any day in the organization's taxable year to which such valuation applies, provided the organization follows a consistent practice of valuing such asset as of such date in all taxable years. For purposes of paragraph (c)(2)(v) of this section, an asset held by the organization for part of a taxable year shall be taken into account by multiplying the fair market

value of such asset by a fraction, the numerator of which is the number of days in such taxable year that the foundation held such asset and the denominator of which is the number of days in such taxable year.

(vii) *Medical research in conjunction with a hospital.* The organization need not be formally affiliated with a hospital to be considered primarily engaged directly in the continuous active conduct of medical research in conjunction with a hospital, but in any event there must be a joint effort on the part of the research organization and the hospital pursuant to an understanding that the two organizations will maintain continuing close cooperation in the active conduct of medical research. For example, the necessary joint effort will normally be found to exist if the activities of the medical research organization are carried on in space located within or adjacent to a hospital, the organization is permitted to utilize the facilities (including equipment, case studies, etc.) of the hospital on a continuing basis directly in the active conduct of medical research, and there is substantial evidence of the close cooperation of the members of the staff of the research organization and members of the staff of the particular hospital or hospitals. The active participation in medical research by members of the staff of the particular hospital or hospitals will be considered to be evidence of such close cooperation. Because medical research may involve substantial investigation, experimentation and study not immediately connected with hospital or medical care, the requisite joint effort will also normally be found to exist if there is an established relationship between the research organization and the hospital which provides that the cooperation of appropriate personnel and the use of facilities of the particular hospital or hospitals will be required whenever it would aid such research.

(viii) *Commitment to spend contributions.* The organization's commitment that the contribution will be spent within the prescribed time only for the prescribed purposes must be legally enforceable. A promise in writing to the donor in consideration of his making a

contribution that such contribution will be so spent within the prescribed time will constitute a commitment. The expenditure of contributions received for plant, facilities, or equipment, used solely for medical research purposes (within the meaning of subdivision (ii) of this subparagraph), shall ordinarily be considered to be an expenditure for medical research. If a contribution is made in other than money, it shall be considered spent for medical research if the funds from the proceeds of a disposition thereof are spent by the organization within the five-year period for medical research; or, if such property is of such a kind that it is used on a continuing basis directly in connection with such research, it shall be considered spent for medical research in the year in which it is first so used. A medical research organization will be presumed to have made the commitment required under this subdivision with respect to any contribution if its governing instrument or by-laws require that every contribution be spent for medical research before January 1 of the fifth year which begins after the date such contribution is made.

(ix) *Organizational period for new organizations.* A newly created organization, for its "organizational" period, shall be considered to be primarily engaged directly in the continuous active conduct of medical research in conjunction with a hospital within the meaning of subdivisions (v) and (vii) of this subparagraph if during such period the organization establishes to the satisfaction of the Commissioner that it reasonably can be expected to be so engaged by the end of such period. The information to be submitted shall include detailed plans showing the proposed initial medical research program, architectural drawings for the erection of buildings and facilities to be used for medical research in accordance with such plans, plans to assemble a professional staff and detailed projections showing the timetable for the expected accomplishment of the foregoing. The "organizational" period shall be that period which is appropriate to implement the proposed plans, giving effect to the proposed amounts involved and the magnitude

and complexity of the projected medical research program, but in no event in excess of three years following organization.

(x) *Examples.* The application of this subparagraph may be illustrated by the following examples:

*Example 1.* N, an organization referred to in section 170(c)(2), was created to promote human knowledge within the field of medical research and medical education. All of N's assets were contributed to it by A and consist of a diversified portfolio of stocks and bonds. N's endowment earns 3.5 percent annually, which N expends in the conduct of various medical research programs in conjunction with Y hospital. N is located adjacent to Y hospital, makes substantial use of Y's facilities and there is close cooperation between the staffs of N and Y. N is directly engaged in the continuous active conduct of medical research in conjunction with a hospital, meets the principal purpose test described in subdivision (iv) of this subparagraph, and is therefore an organization described in section 170(b)(1)(A)(iii).

*Example 2.* O, an organization referred to in section 170(c)(2), was created to promote human knowledge within the field of medical research and medical education. All of O's assets consist of a diversified portfolio of stocks and bonds. O's endowment earns 3.5 percent annually, which O expends in the conduct of various medical research programs in conjunction with certain hospitals. However, in 1974, O receives a substantial bequest of additional stocks and bonds. O's budget for 1974 does not take into account the bequest and as a result O expends only 3.1 percent of its endowment in 1974. However, O establishes that it will expend at least 3.5 percent of its endowment for the active conduct of medical research for taxable years 1975 through 1978. O is therefore directly engaged in the continuous active conduct of medical research in conjunction with a hospital for taxable year 1975. Since O also meets the principal purpose test described in subdivision (iv) of this subparagraph, it is therefore an organization described in section 170(b)(1)(A)(iii) for taxable year 1975.

*Example 3.* M, an organization referred to in section 170(c)(2), was created to promote human knowledge within the field of medical research and medical education. M's activities consist of the conduct of medical research programs in conjunction with various hospitals. Under such programs, researchers employed by M engage in research at laboratories set aside for M within the various hospitals. Substantially all of M's assets consists of 100 percent of the stock of X corporation, which has a fair market value of approximately 100 million dollars. X pays M approximately 3.3 million dollars in dividends

annually, which M expends in the conduct of its medical research programs. Since M expends only 3.3 percent of its endowment, which does not constitute a significant percentage, in the active conduct of medical research, M is not an organization described in section 170(b)(1)(A)(iii) because M is not engaged in the continuous active conduct of medical research.

(xi) *Special rule for organizations with existing ruling.* This subdivision shall apply to an organization that prior to January 1, 1970, had received a ruling or determination letter which has not been expressly revoked holding the organization to be a medical research organization described in section 170(b)(1)(A)(iii) and with respect to which the facts and circumstances on which the ruling was based have not substantially changed. An organization to which this subdivision applies shall be treated as an organization described in section 170(b)(1)(A)(iii) for a period not ending prior to 90 days after February 13, 1976 (or where appropriate, for taxable years beginning before such 90th day). In addition, with respect to a grantor or contributor under sections 170, 507, 545(b)(2), 556(b)(2), 642(c), 4942, 4945, 2055, 2106(a)(2), and 2522, the status of an organization to which this subdivision applies will not be affected until notice of change of status under section 170(b)(1)(A)(iii) is made to the public (such as by publication in the Internal Revenue Bulletin). The preceding sentence shall not apply if the grantor or contributor had previously acquired knowledge that the Internal Revenue Service had given notice to such organization that it would be deleted from classification as a section 170(b)(1)(A)(iii) organization.

(d) *Governmental unit.* A governmental unit is described in section 170(b)(1)(A)(v) if it is referred to in section 170(c)(1).

(e) *Definition of section 170(b)(1)(A)(vi) organization—(1) In general.* An organization is described in section 170(b)(1)(A)(vi) if it is:

(i) A corporation, trust, or community chest, fund, or foundation, referred to in section 170(c)(2) (other than an organization specifically described in paragraphs (a) through (d) of this section), and

(ii) A "publicly supported" organization.